

# Penalties for White-Collar Crime

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This paper will comment on some general things about the state of penalties not just for fraud in particular, but for white-collar crime in general. There are two simple reasons for this. First, the problem of unsatisfactory penalties for fraud is part of a more general problem of limp or inappropriate penalties for white-collar crime. Second, fraud is a serious part of the problem in almost every area of white-collar crime. In environmental regulation, there are problems with providing false effluent data to regulators; with pharmaceuticals regulation, there have been very serious problems of health authorities being provided with fraudulent data on the safety and efficacy of drugs. Fraud is a major issue in the regulation of companies and securities, prudential regulation (banking, insurance), occupational health and safety and consumer protection. Too often we forget that not only does fraud cost us millions of dollars, fraud also kills. In Australia, we have been woefully neglectful of frauds that put lives at risk.

The most serious frauds, particularly of the latter life-threatening sort, are perpetrated by corporations. For this reason, this paper will concentrate on penalties for corporate offences. There is another reason for giving this priority, however, that has to do with the parlous international reputation of Australian regulatory institutions. For example, so far this year, I have attended three conferences in the Northern hemisphere that have addressed the topic of white-collar crime, and it is noticeable that jokes about Australian business have become common at such events. Queensland's own Joh Bjelke-Petersen features in cautionary tales that are told in the Northern hemisphere about the shocking state of our business and political institutions. It is a mystery why so many English people have heard of the alleged antics of Joh Bjelke-Petersen, but they do not know the name of a single governor of an American state who has been under a cloud for corruption. Perhaps we are just more colourful than the Americans. The fact which we have to deal with as a nation, however, is that our business regulatory institutions are 'on the nose' internationally. For the moment, the pressure has been lifted somewhat because the Japanese are even more 'on the nose'. But the Bjelke-Peterson trial and other media 'spectaculars' coming down the track will shift the spotlight back onto Australia.

It is no use complaining that it is unfair picking on Australia; because it is not unfair. We have deluded ourselves for too long about the integrity of our business and political institutions. A public relations campaign to counter the collapse in international confidence in Australia will not wash because the allegation that we are soft on corporate crime is demonstrably true. To restore confidence in

Australian business institutions, our political leaders must do something dramatic. That something should be to put some teeth into corporate criminal law.

It is vital to do this because our dismal international reputation is a major threat to our economy and a significant cause of the sorry economic predicament we already have. Australian business leaders who give 'presentations' to the New York investment community hear the jibes. Investment confidence in Australia is haemorrhaging because of our reputation for rigged, corrupt markets where the competition is done by foul means rather than fair.

If you look at almost any area of law enforcement directed against business - as Peter Grabosky and I did in our book, *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies* - we find agencies with a dismal enforcement record by international standards. We find them under-resourced, operating with statutes which provide for wrist-slapping financial penalties. This is true in companies and securities regulation (as we still breathlessly await our first-ever conviction of an insider trader)<sup>1</sup>, environmental enforcement, occupational health and safety, consumer protection, regulation of the media or banking and insurance regulation.

It is even true of the organisation that Grabosky and I concluded was the Australian regulatory agency during the 1980s that imposed the toughest enforcement - the Trade Practices Commission. The Trade Practices Commission is responsible for enforcement concerning misleading representations to consumers, price-fixing rip offs, abuse of market power and a range of other forms of anti- competitive conduct.

But even here, where our enforcement has been most credible, compare what we are doing today with what our major trading partners are doing. Japan and the United States provide for tough prison sentences for senior executives of companies that breach their trade practices laws. Actual use of these severe prison terms has been rare in Japan, but common in the US. The original *Murphy Trade Practices Act 1974* (Cwlth) provided for imprisonment as a sanction. The provision was removed in the 1977 amendments to the Act.

Notwithstanding the rhetoric of deregulation, the facts are that under both the Reagan and Bush Administrations the punitiveness of corporate crime enforcement increased. The percentage of individual antitrust offenders sentenced to gaol increased from 38 per cent under Carter to 54 per cent under Reagan and the time served in gaol jumped markedly.

Restoring imprisonment as a sanction under the Trade Practices Act is not being advocated here. However, we must understand the reasons why our major trading partners are right to perceive us as timid compared to themselves in our approach to business regulatory enforcement. In fact, we are so timid that the financial press never refers to Trade Practices offences as corporate crimes or their

perpetrators as corporate criminals. Indeed as a matter of law only breaches of Part V of the act are criminal.

In response to recent criticism of our Trade Practices penalties, the Attorney-General has stated publicly that he is seeking to persuade his Cabinet colleagues to increase the maximum penalties from the present \$250,000 to \$10 million. But let us compare this to what is happening in the rest of the OECD. The US Sentencing Commission this year sent its long-awaited recommendations to Congress to increase penalties for corporate crime. Its recommendations will probably become US law in November 1991. For the most serious type of corporate crime possible, the guidelines provide for a maximum criminal fine of US\$290 million. Yet for antitrust offences, even higher fines are conceivable because a firm can be fined up to 80 per cent of the value of the commerce affected by an antitrust offence. Hence, if an oil company engaged in price fixing with a competitor on all of its oil sales and those sales amount to a billion dollars, it could be fined up to \$800 million if it is a repeat offender which is maximally culpable for the offence.

Already in the US today we are seeing corporate penalties with this number of digits. The judge in the Exxon Valdez oil pollution case recently rejected a US\$100 criminal penalty consent agreement as too lenient (even though this was on top of a \$900 million civil settlement and over a billion in voluntary clean-up). In the Drexel Burnham Lambert insider trading case we saw consent agreements for civil penalties in excess of US\$600 million (including a US\$78 million criminal fine) and a ten-year prison sentence for Michael Milkin (Stewart 1991).

The US is not the only country where antitrust financial penalties, like other sanctions against business offenders, are rising sharply. Total anti-cartel penalties imposed by the Japanese Fair Trade Commission (FTC) rose from 147 million Yen in 1987 to 419 million in 1988 to 803 million in 1989 to 12,560 million in 1990. This will rise further if the FTC gets approval for maximum fines to rise from 2 per cent to 6 per cent of the sales of cartel offenders. In Europe the maximum penalties that can be imposed are higher than in the US or Japan. Way back in 1980 the Commission of the European Economic Community (EEC) recommended that the EEC fine IBM US\$2.3 billion for alleged restriction of competition in the European computer market. This fine was never imposed. But such extraordinary fines are possible because of the EEC power to impose fines up to a maximum 10 per cent of a firm's worldwide sales. Last month the Swedish company, Tetra-Pak was fined A\$114 million by the EEC for discriminatory and predatory pricing.

In this international environment of governments flexing their muscles to secure clean competitive markets where both consumers and investors get fair treatment, Australia has missed the boat. In fact we have missed the boat so badly that gestures such as increasing penalties under the Trade Practices Act to \$10 million go nowhere near far enough. We surely do need dramatic increases in the

financial penalties available under all our business regulatory statutes. But to be politically realistic, there is no prospect that we could increase financial penalties to such a degree that Northern hemisphere cynics about the corruptness of Australian business will be convinced that we are being as tough on business crime enforcement as they are.

This seems politically unrealistic because the gap between the level of our maximum penalties and theirs is now so wide. Anything we do now will be better than nothing, but it will still be seen as a limp gesture of catch-up with the rest of the world. We need a dramatic innovation in corporate crime enforcement to make the world sit up and take notice of an Australia that is taking extraordinary measures to clean up its act.

Senator Gareth Evans showed how this could be done in speeches he gave in 1982 and 1983 on the idea of an equity fine as a sanction against corporate offenders. Evans was howled down for proposing something that was seen at the time as horrendously unsympathetic to business. Similarly, when the Australian Law Reform Commission floated the equity fine proposal in a discussion paper a few years later, there were no political supporters to be found. Ironically, the very radicalism and innovativeness of the equity fine that fomented such business and political rejection makes it the ideal instrument for signalling to the world a new Australian determination to get serious about corporate crime.

What is the equity fine idea? It stems from an appreciation of the fact that the cash fine can put us in what Professor Coffee of Columbia University called a deterrence trap. If the chances of getting caught for say, insider trading, are only one in a hundred and if the average returns to insider trading were say \$1 million, then the penalty for insider trading would have to be set at over \$100 million to make it rational to desist from the practice. The fine has to be so high that it is likely to bankrupt many corporate offenders, putting innocent workers out of jobs.

The equity fine gets us out of the deterrence trap by fining the firm in equity instead of cash. A 1 per cent equity fine means the firm must issue one new share for every 100 shares owned by shareholders. The new shares might be issued to a victim compensation fund or to the state. This should cause an instantaneous 1 per cent drop in the market value of all shareholdings. Unlike the cash fine, the equity fine does not deplete the capital available for investment. Instead of depleting the firm's liquid assets, it simply reallocates ownership of both fixed and liquid assets. And it gets shareholders upset with their management!

There are other reform options beyond becoming just another country which increases the level of cash fines or prison sentences for corporate criminals. Corporate probation, adverse publicity orders and community service orders are examples. These ideas were well developed by the South Australian Criminal Law and Penal Methods Reform Committee (1978) - (the Mitchell Committee). Again these recommendations advanced by the now Governor of South Australia

were ignored at the time. Professor Brent Fisse of the University of Sydney Law School is the world's leading expert in innovative corporate sanctions (Fisse 1981). His ideas have been influential in the United States and parts of them have been adopted there, but they have been ignored by Australian governments.

In our new international predicament as a pariah nation of business shysters, such ideas would bear careful re-examination by a political leadership interested in making a decisive move to scotch that image. But then perhaps our foreign critics are right and the real reasons why Australian politicians refuse to get tough on corporate crooks are to be found in the evidence before the Fitzgerald, Tasmanian bribery and WA Inc Royal Commissions?

In some areas the debate about white-collar crime penalties is, as Professor Tomasic has said in the past, purely academic. What does it matter what the penalties are for insider trading when we never convict anyone? Trade Practices penalties seems a priority area for reform precisely because that is one of the few business regulatory domains where convictions of major businesses do occur on a regular basis. I can see no reason for prioritising increases in gaol terms for common fraud. The effect of that will be to increase sentences for social security cheats and other minor fraudsters who account for most of our fraud convictions. And as research at the Australian National University is showing, criminal enforcement is not the most effective way to tackle the considerable fiscal loss caused by overpayments to social security clients.

In addition to the rethinking of corporate sanctions mentioned in this address, seizure of assets is also an important area of reform if we are to concentrate our energies on sanctions that target (and that can hurt) the biggest sharks of Australian business. However, Professor Freiberg will provide us with a more comprehensive treatment of the problems and advantages associated with that approach (see the next chapter in this volume).

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<sup>1</sup> A former employee of the National Companies and Securities Commission was convicted of insider trading in 1991.

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